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No. 07-451

FILED

OCT 31 2007

OFFICE OF THE CLERK
SUPREME COURT, U.S.

In The

Supreme Court of the United States

PANHANDLE PRODUCERS AND ROYALTY OWNERS ASSOCIATION; CAMBRIDGE PRODUCERS, LTD.; and THOMAS R. CAMBRIDGE,

Petitioners,

v.

OKLAHOMA TAX COMMISSION; and THOMAS E. KEMP, JR., JERRY B. JOHNSON, and CONSTANCE IRBY, tax commissioners, all in their official capacities,

Respondents.

On Petition For Writ Of Certiorari To The Supreme Court Of Oklahoma

BRIEF IN OPPOSITION

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QUESTION PRESENTED

Should the Petition for Writ of Certiorari be denied in a privileges-and-immunity attack against Oklahoma's income tax collection regimen that requires withholding from oil and gas royalty income that is leaving the State of Oklahoma, where long-standing (and rarely challenged) jurisprudence approves of withholding from nonresidents?

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RESTATEMENT OF THE CASE

Oklahoma has a state income tax system, which includes taxes on income derived from in-state oil and gas royalty payments. The Oklahoma Income Tax Code withholding provisions are found at 68 O.S. 2001 & Supp. 2007, §§ 2385.1-2385.28. Under the Oklahoma law, each remitter ("any person who distributes revenue to royalty interest owners") must deduct and withhold from each payment being made to any royalty interest owner an amount equal to five percent of the gross amount payable to the owner for oil and gas produced in this State. *Id.* § 2385.25(2); *see id.* § 2385.26(A). For the purpose of the withholding statute, "royalty interest owner" is defined as an individual who owns a non-working interest in oil or gas production. *See id.* § 2385.25(3). Royalty interest owners from whom taxes are withheld and who file an Oklahoma income tax return are entitled to a credit against the tax as shown on the return in the amount withheld by the remitter. *See id.* § 2385.26(C). If the amount withheld is greater than the tax due, the taxpayer filing the return is entitled to a refund in the amount of the overpayment. *See id.* Remitters are required to pay the amounts withheld from the royalty owners to the Oklahoma Tax Commission on a quarterly basis for deposit in the Income Tax Withholding Fund. *See id.* § 2385.27(A), (E).

The obligation to deduct and withhold does not apply to those payments made to: "1. Current or permanent residents of Oklahoma; 2. The United States, this state or any state or federal agency or

political subdivision; 3. Any charitable institution; or 4. Any federally recognized Indian tribe." 68 O.S. Supp. 2007, § 2385.26(B). State and federal governments, charitable institutions, and Indian tribes are not subject to State income tax. *See id.* §§ 2353(12), 2355; 68 O.S. 2001, § 2359. "Current or permanent residents" are subject to an identical tax on income, including royalty payments; however, under the withholding exemption, the tax is not withheld from their royalty payments by the remitter, but rather is due on a quarterly basis or at the time the yearly return is filed. *See* 68 O.S. Supp. 2007, §§ 2358(A)(4)(a), 2368, 2375, 68 O.S. 2001 §§ 2385.7, 2385.9.

All royalty proceeds from Oklahoma properties are subject to Oklahoma income tax, irrespective of the residency of the mineral owner. Income tax is imposed upon the "Oklahoma taxable income" of every resident taxpayer or nonresident taxpayer. *See* 68 O.S. Supp. 2007 § 2355(A). "Oklahoma taxable income" means taxable income reportable to the federal government under the Internal Revenue Code, adjusted as provided in the Oklahoma Income Tax Code. *See id.* § 2353(12). Income from oil and gas properties is allocated to the situs of such property. *See id.* § 2358(A)(4)(a). Nonresident taxpayers must report income attributable to the ownership of any interest in real or personal property in Oklahoma. *See id.* § 2362. Oklahoma's imposition of income tax on income of nonresidents from oil and gas produced from Oklahoma properties was upheld in *Shaffer v. Carter*, 252 U.S. 37 (1920). This Court noted that it

had always recognized rights of the States to exercise the widest liberty with respect to imposition of taxes (*See id.* at 51) and that just as a State may impose general income taxes upon its own citizens, it may levy a duty of like character, and not more onerous in its effect, upon incomes accruing to nonresidents from their property or business within the State. *See id.* at 52.

In the instant matter nonresident taxpayers sued in state court and have been denied relief through the highest court in Oklahoma. They now petition for discretionary review challenging the withholding procedures under the privileges and immunity clause. U.S. Const. art. IV, § 2 cl. 1.

REASONS FOR DENYING WRIT

THE RARELY CHALLENGED ISSUE OF INCOME TAX WITHHOLDING FROM NONRESIDENT TAXPAYERS DOES NOT INVOLVE A CONFLICT OF AUTHORITY, AS ALL TRIBUNALS ARE IN ACCORD WITH LONGSTANDING JURISPRUDENCE ANNOUNCED BY THIS COURT IN *TRAVIS V. YALE & TOWNE MFG. CO.*, 252 U.S. 60 (1920).

Oklahoma is one of many States which have determined that withholding at the source of income is appropriate when it comes to nonresident taxpayers. Around the country state income tax withholding from nonresidents is required for various transactions

and disbursements. These include nonresident sale of real property, nonresident contractor payments, nonresident entertainer payments and disbursements from pass-through entities (such as partnerships, "S" corporations, LLCs and trusts) where such payments are made to out-of-state taxpayers.[1] Oklahoma, along with the royalty withholding statutes challenged in this instant matter, also requires withholding with respect to pass-through entities.[2] 68 O.S. Supp. 2007, §§ 2385.29-2385.31. Thus, it is fair to suggest that non-wage withholding, which sets aside funds that are headed out of state to nonresidents, is reasonably commonplace around the country.

There is a paucity of cases from these many jurisdictions that have reported challenges to the

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[1] See for example state statutes requiring non-wage withholding for non-resident disbursements: California, Cal. Rev. & Tax. Cd. § 18662(a)-(c) (general withholding statutes); Delaware, 30 Del. Code Ann. § 1158 (Subchapter S corporations); Hawaii, Haw. Rev. Stat. § 235-68(b) (sale of real property); Maryland, Md. Code Ann. Tax-Gen. § 13-803; Michigan, Mich. Comp. Laws Ann. § 206.351(2) (pass-through entities); Minnesota, Minn. Stat. § 290.9201, Subd. 7 (entertainer withholding); Mississippi, Miss. Code Ann. § 27-7-308 (real property); North Carolina, N.C. Gen. Stat. § 105-163.3(a) (contractor withholding); Ohio, Ohio Rev. Code Ann. § 5747.40 (pass-through entities); Pennsylvania, Pa. Stat. Ann. 72 § 7324(a) (S corporations and pass-through entities); South Carolina, S.C. Code Ann. § 12-8-540 (withholding for rents and royalty payments); Vermont, Vt. Stat. Ann. 32 § 5847(a) (real estate); and West Virginia, W. Va. Code § 11-21-71a (pass-through entities).

[2] The Oklahoma withholding statute for pass-through entities has not been challenged and remains current and valid.

practice of withholding from nonresident taxpayers. The issue was resolved by this Court eighty-seven years ago by *Travis v. Yale & Towne Mfg. Co.*, 252 U.S. 60 (1920). It was held:

> The contention that an unconstitutional discrimination against noncitizens . . . [by] confining the withholding at source to the income of nonresidents is unsubstantial. That provision does not in any wise increase the burden of the tax upon nonresidents, but merely recognizes the fact that as to them the state imposes no personal liability, and hence adopts a convenient substitute for it. *Id.* at 72

Since that time there has been little consideration given to revisiting the issue. In 1967 an attack on "disparate" withholding was rejected by the South Carolina Supreme Court in *Peoples National Bank v. South Carolina Tax Commission*, 156 S.E. 2d 769 (S.C. 1967) (concerning trust distributions). As that court noted, the legitimate purpose of the withholding statute "was to assure the collection of income taxes due to the State on income distributable to nonresident beneficiaries, before the funds should be sent beyond the jurisdiction of the State." *Id.* at 191. In 1990, the issue was again rejected in South Carolina upon Equal Protection and Privileges and Immunities grounds. *S.C. Dept. Of Rev. Commission Decision*, 90-4 (Jan. 23, 1990) (administrative ruling). Appendix 1. In 1993 the issue was rejected in Michigan on equal protection grounds. *See Molter v. Department of Treasury*, 505 N.W. 2d 244, 253 (Mich. 1993), concerning

income tax withheld only from nonresidents on payment of deferred compensation. That court concluded:

> Because the state income tax applies equally to all former residents who receive deferred compensation, we hold that plaintiff's equal protection rights have not been violated by the state's practice of withholding income taxes from his deferred compensation plan distributions. *Id.* at 253.

In 2007 the issue was again rejected in this instant case.[3]

The Privileges and Immunities Clause provides, "The Citizens of each State shall be entitled to all Privileges and Immunities of Citizens in the several States." U.S. Const. art. IV, § 2 cl. 1. One of the rights intended to be secured by this provision is that a citizen of one State may carry on business in another State without being subjected to taxes more onerous than the latter State's own citizens. *See Shaffer*, 252 U.S. at 56.

In the statutes under review, nonresidents are not taxed more heavily than residents; the difference in treatment is only in the means of collecting the tax. The income tax is withheld from nonresident taxpayers' royalty payments, whereas Oklahoma taxpayers pay their tax in quarterly estimates or with

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[3] Petitioners have abandoned their equal protection and commerce clause claims in their petition.

their yearly tax return. Income taxes normally are assessed at the source, the moment the income is received by the taxpayer. *See, e.g., Begier v. I.R.S.*, 496 U.S. 53, 61 (1990). "Withholding and estimated tax remittances are not taxes in their own right, but methods for collecting the income tax." *Baral v. U.S.*, 528 U.S. 431, 436 (2000).

As noted, a difference in withholding requirements between residents and nonresidents was approved against a Privileges and Immunities Clause challenge in *Travis*, where the issue was whether New York law violated the Privileges and Immunities Clause by discriminating against nonresidents by requiring employers to withhold the tax from nonresidents' salaries, but not residents' salaries.

In *Travis* this Court noted that the law did not increase the burden of tax upon nonresidents, but merely recognized the fact that as to them a state imposed no personal liability, and hence adopted a convenient substitute for it. *See* 252 U.S. at 76. The adoption of a withholding requirement for nonresident royalty owners is justified by the fact that collection of the tax from nonresidents is more difficult than collecting tax from residents. Withholding tax from nonresidents' mineral interest proceeds is a rational means of addressing this problem.

The petition should be denied.

CONCLUSION

The Petition of Certiorari should be denied as the issue, which has been settled for over eight decades, has raised little attention through the years and has produced no genuine conflicts in authority.

Respectfully submitted,

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APPENDIX A

Commission Decision 90-4

Case Information:

Docket/Court: 90-4, South Carolina Dept. of Rev. Commission Decisions

Date Issued: 01/23/1990

Tax Type(s): Corporate Income Tax

OPINION

In Re:

A Finding Concerning A Dispute Over Withholding On The Sale Proceeds From Real Estate Sold By XYZ

FINDINGS OF FACT

XYZ is a nonresident of South Carolina who, until July 31, 1989, was the owner of property located at X, South Carolina. On that date, she sold the property to DFG. Act 189, Part II, Section 55(b) of the Acts of 1989, required the DFGs, as the buyers, to withhold from the proceeds payable to the nonresident seller 7% of the proceeds of the sale. XYZ objected on the grounds that the provisions of Section 55(b) are violations of the Equal Protection Clause and the Privileges and Immunities Clause of the United States Constitution. Based on these assertions, XYZ sought a refund from the Office Services Division. After the refund denial, the matter came to us.

CONCLUSIONS OF LAW

Effective July 1, 1989, Act 189, Part II, Section 55(b), required every person:

> "Making payment to a nonresident of the proceeds of the sale of real property and tangible personal property shall deduct and withhold on the payments an amount equal to seven percent of the total payment to individuals and five percent of the total payment to corporations . . . "

This statute is a withholding statute designed to apply the withheld amount to the taxpayer's income tax liability for the tax year. Here, the tax year from XYZ ended December 31, 1989. The issue of whether a refund is due is now somewhat moot since the withheld amount can be applied to the 1989 income tax liability. Any excess withholding will be refunded. Thus the issuance of a refund is premature here until the 1989 return is filed.

We further note another reason why we are unable to grant a refund of the withholding tax involved. The only challenge in the matter before us is the constitutional challenge based on the Equal Protection Clause and the Privileges and Immunities Clause. We have no power to declare a statute unconstitutional. (*See South Carolina Tax Commission v. South Carolina Tax Board of Review*, 278 S.C. 566, 299 S.E.2d 489 (1983).) Nonetheless, we set forth our views on why the statute is constitutional.

In taxation, the Equal Protection Clause requires a consideration of three elements. The classification subject to tax cannot be arbitrary, the classification must be based upon a reasonable difference between the classes, and those within the class must be treated the same. *Allegheny Pittsburgh Coal Company v. County Commission of Webster County, West Virginia*, 109 S.Ct. 633 (1989). Here, the classification is not arbitrary and is based on a reasonable difference between the classes. The class is based on the rational need for the state to collect income tax from taxpayers who, as nonresidents, dispose of assets in the state and thus remove from the state a potential avenue for the collection of the tax generated by the sale. The reasonable difference between residents and nonresidents is the difficulty in collecting tax on a transaction where the funds or assets generated from the transaction have been removed from the state.

> "The practical difficulties involved in attempting to collect the tax due, after out of state distribution of the funds, are apparent." *Peoples National Bank v. South Carolina Tax Commission*, 250 S.C. 187, 156 S.E.2d 769 (1967).

Thus, a classification based on nonresident's removing assets from the state is not only not arbitrary, but is in fact a reasonable and approved method in this state. Finally, it is without dispute that all members of the class are treated the same in that all nonresidents are subject to the withholding requirements. Based on the above, we submit the statute is not in

violation of the Equal Protection Clause of the United States Constitution.

We further believe the statute does not violate the Privileges and Immunities Clause. There is no automatic violation of that clause based solely upon showing that one group is required to perform a duty not imposed upon another group. Rather, if the state has a legitimate object it seeks to accomplish and if the duty has a substantial relationship to that object, the statute is constitutional. *New Hampshire v. Piper*, 470 U.S. 274, 284 (1985). As our Court said in *Spencer v. South Carolina Tax Commission*, 281 S.C. 492, 316 S.E.2d 386, 388 (1984):

> "We must next address the more difficult question of whether substantial reasons justify the discrimination and whether the degree of discrimination bears a close relationship to those reasons . . . "

In the case of the withholding on nonresidents, substantial reasons exist for imposing the withholding requirement and further the withholding requirement is closely tailored to accomplish the objective sought by the statute. A nonresident selling property in South Carolina may effectively remove any ability of the state to collect the tax generated from such a sale since the assets are removed from the state and are no longer subject to levy or attachment. A resident, however, is subject to the full authority of the Commission's levy power and his presence in the state provides a ready avenue for enforcement of any resulting tax liability.

The withholding requirement is closely tailored to accomplish the objective. The withholding requirements assures that assets are available from which the taxpayer's liability may be satisfied. Further, the withholding is not a permanent condition. Rather, it is only a temporary situation since once the taxpayer files the South Carolina return setting forth the South Carolina tax liability, any excess withholding is refunded to the taxpayer. Such a procedure does not unduly infringe upon the Privileges and Immunities Clause.

We reiterate that the refund issue is now a moot question since a refund is available to the extent it exceeds the 1989 income tax liability. However, since the constitutional issues attempted to be raised are significant ones, we have taken this opportunity to express our view as to why the statute is constitutional. Based on the above, the refund claim is denied.

AND IT IS SO FOUND AND ORDERED.

SOUTH CAROLINA TAX COMMISSION